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# Defining Option Spreads



Toronto Stock Exchange | TSX Venture Exchange | **Montréal Exchange** | Natural Gas Exchange | Montréal Climate Exchange | Boston Options Exchange

Canadian Derivatives Clearing Corporation | TMX Datalinx | Equicom | PC Bond | Shorcan

# What is an Option Spread?



- Simultaneous purchase and sale of options
- Different expiration months, strike prices or both.
- Same underlying asset.



# What is an Option Spread?



- Each option position is a leg.
  - Simple spreads (vertical, horizontal, etc.)
    - 2 legs
  - Complex spreads (butterflies, condors, etc)
    - 3 or more legs



# Types of Spreads



Spread	Expiration Month	Strike Price
Vertical	Same	Different
Horizontal	Different	Same
Diagonal	Different	Different



# Credit vs Debit Spreads



- Credit Spread
  - Option sold  $>$  option purchased
- Debit Spread
  - Options sold  $<$  option purchased



# Credit vs Debit Spreads



	Credit Spread	Debit Spread
<b>Objective</b>	Generate cash flow	Profit from a directional move
<b>Market Condition</b>	Neutral or directional	Directional
<b>Risk</b>	(Difference between the strike prices) – Net premium received	Debit (Net premium paid)
<b>Profit Potential</b>	Credit (Net premium received)	(Difference between the strike prices) – Net premium paid



# Vertical Spreads



- Purchase and sale of either calls or puts
- Same expiration month
- Different strike prices



# Vertical Spreads



Strategy	Market Outlook	Debit/Credit
<b>Bull Call Spread</b>	Bullish	Debit
<b>Bear Call Spread</b>	Bearish	Credit
<b>Bull Put Spread</b>	Bullish	Credit
<b>Bear Put Spread</b>	Bearish	Debit



# Vertical Spreads



- Vertical Credit Spreads
  - **Long** call/put with **higher** strike price
  - **Short** call/put with **lower** strike price
  
- Vertical Debit Spreads
  - **Long** call/put with **lower** strike price
  - **Short** call/put with **higher** strike price



# Horizontal Spreads



- Also referred to as 'Time spreads' or 'Calendar spreads'
- Purchase and sale of either calls or puts
- Different expiration months
- Same strike price



# Horizontal Spreads



- Calendar Spreads
  - **Short near-term call/put**
  - **Long long-term call/put**
  
- Reverse Calendar Spreads
  - **Long near-term call/put**
  - **Selling long-term call/put**



# Diagonal Spreads



- Combination of a vertical and horizontal spread.
- Purchase and sale of either calls or puts
- Different expiration months
- Different strike prices



